United States
Department of
Agriculture

Agricultural
Marketing
Service

Concentration in Agriculture

A Report of the USDA Advisory Committee on Agricultural Concentration

June 1996

LETTER OF TRANSMITTAL

The Honorable Dan Glickman
Secretary of Agriculture

Mr. Secretary:

Concentration and vertical integration in agriculture generally are associated with positive results, including more efficient production, risk management, international competitiveness, product quality improvement, and food safety advantages. At the same time, however, concentration and vertical integration in agriculture can cause problems and concerns, including distorted price discovery, unequal access to vital market information, environmental degradation, and, perhaps most disturbing, dysfunctional interactions between producers, handlers, packing plants, and retailers and distributors.

The process for dealing with these problems historically has involved occasional investigations and, sometimes, government intervention to address a crisis situation. *We believe it is possible to prevent most of these problems. Major policy efforts should be directed to creating an atmosphere of open disclosure of basic operating facts, including many aspects of price discovery, earnings levels of packers and feeders, environmental management concerns, and contract terms between integrators and producers.* In this atmosphere of more and better information, markets will work better, fewer problems will occur, and any problems that do occur will be more successfully and convincingly investigated and resolved.

It has been a pleasure to work with you on these important issues. The outstanding committee you appointed has worked very hard. Attendance and participation have been extraordinary, as have the civility and respect among members for individual viewpoints. The USDA staff have given first class support. We have benefited from much detailed work, performed at many levels of the food industry and by USDA's supporting agencies.

We have seen our role more as developing a policy direction rather than redoing detailed economic studies. We have tried to connect the many factors relating to the trends of agricultural industry restructuring and to develop a comprehensive basis for policy. We are honored to have been asked to serve in this regard. On behalf of the full committee, I want to express our appreciation for the opportunity to consider these issues. We hope this report will be useful to you in carrying out your responsibilities.

Respectfully submitted,

Daniel I. Padberg

Daniel I. Padberg
Professor Emeritus and
Chairman

Respectfully signed and submitted by:

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Duties & Responsibilities Under the Charter for the Advisory Committee on Agricultural Concentration

Duties and Responsibilities:

a) Review market concentration in the meat packing industry, including red meat and poultry, through analysis of the recent USDA study of concentration in the red meat packing industry and other relevant studies. To the extent dealt with in these studies, such review should consider:

1) The available information on regional procurement markets for slaughter cattle in the continental United States;

2) The effects that slaughter cattle procurement practices and concentration have on the purchasing and pricing of slaughter cattle by beef packers;

3) The use of captive cattle, hog, and poultry supply arrangements by packers and the effects of such arrangements on markets;

4) The economics of vertical integration and of coordination arrangements in the hog, lamb, and poultry slaughtering and processing industries;

5) The available data on pricing and procurement by hog and poultry slaughtering plants;

6) The pertinent research literature on issues relating to the structure and operations of the meat and poultry packing industries; and

7) The information on the availability of rail cars to transport agricultural products, especially livestock and grain, and the effect of competition in the railroad industry on rates for livestock and grain shippers.

b) Review the application of the Packers and Stockyards Act of 1921, as amended, taking into account its effect on concentration and vertical integration in procurement, pricing, and contractual agreements regarding livestock and poultry.

c) Review how and whether the information gathering and reporting by the Agricultural Marketing Service is affected by industry structure, including concentration, and the potential effects on markets and producers; whether additional statutory authority to collect data is needed; whether such collection should be mandatory or voluntary and the consequences of each approach; and whether there are other statutory data collection authorities that provide a basis for determinations regarding these issues.

d) Review available information and assess the extent to which concentration in the railroad industry affects the adequacy and availability of rail car service and the rates and prices paid by producers, grain elevators, shippers, and consumers.

e) Examine the farm-to-retail price spread fluctuations and trends for livestock and poultry during the period beginning January 1, 1993, and ending December 1, 1995, noting their historical context and relevant market development.

f) To the extent data is available from existing studies, ascertain whether livestock and poultry concentration is having an effect on consumer prices.

g) Ascertain whether there is adequate information to identify a relationship between concentration in the livestock and poultry industries and effects on the environment, whether further study is needed on this issue, or if there are actions that can or should be taken on the basis of current information.

h) Review the information and services provided to the livestock and grain industry sectors by USDA to determine if USDA can or should do more for small producers, packers, processors, shippers, and retailers in order to assist competition in the marketplace.

i) Review whether USDA lending programs, research projects, and regulatory programs result in or encourage concentration with regard to the livestock and poultry industries.

j) Review types of contractual agreements between producers and processors to determine if both parties have sufficient market information and market power to enable them to negotiate terms with the other party.

Findings and Recommendations

Based on its review of market concentration in the agricultural sector, the Committee shall make findings and recommendations as follows:

1) Whether laws related to the operation of beef, hog, lamb, and poultry industries should be modified to address any identified problems of concentration and vertical integration in these industries.

2) Whether there is adequate price discovery or reporting in the livestock and poultry industries for animals held for market.

3) Whether modifications to USDA lending, research, and regulatory programs are needed to address problems with concentration.

4) Whether actions need to be taken to ensure adequate rail car availability throughout the year.

I. EXECUTIVE SUMMARY

On February 14, 1996, Secretary of Agriculture Dan Glickman announced the formation of a USDA Advisory Committee on Agricultural Concentration. This committee was charged with investigating concentration in virtually any segment of the agricultural economy where it may be evident. The committee was asked to report to the Secretary by June 7, 1996, its findings, determinations, and recommendations for addressing concentration and any adverse impacts that may exist as a result of concentration. The charter outlining the duties and responsibilities to the committee is included in this report.

This report reflects the committee's collective judgment concerning current agricultural issues that arise from increasing concentration among processing and marketing firms which buy farm products and issues associated with mergers and consolidations in the rail industry. The committee has reviewed existing scientific studies and reports from academic scholars and from government agencies. We have studied the reports of analyses commissioned by the Grain Inspection, Packers and Stockyards Administration (GIPSA) concerning concentration in the livestock and meat industries. We have encouraged and received input and advice from trade associations and other industry experts. We have heard the concerns and advice of farmers and others in a public hearing. We have considered the current interpretation and use of antitrust policy.

In general, we find these issues complex and highly charged. The issues elicit strong views and concerns about the balance of economic power, the use of government power, and personal freedom. Indeed, members of the committee have strong views on these topics and we sense that farm producers and others have similarly strong views. In several areas, our perceptions of the balance of power and its use, or misuse, are not well satisfied by economic or other studies of industry behavior. In many cases, the lack of data and information contributes to unsatisfactory studies just as it contributes to distrust and hostility toward large entities--be they firms or farmer-producers.

We hope this report will provide a useful context for a better understanding of concentration in agriculture. We have endeavored to suggest policy directions that are respectful of the diverse public views, but still useful in moving toward a satisfactory resolution of many of the issues associated with concentration in the agricultural economy.

The committee reached broad consensus in a number of important areas. Full consensus was achieved on the broad policy recommendations and, in particular, the full committee emphatically endorses and recommends a policy to support and improve market information as a vital component of a competitive marketplace. Inevitably, however, in a committee representing such diverse viewpoints as this body represents, disagreement is bound to arise. For the most part, our diverging opinions deal with the appropriate measures to implement the policies recommended. Although the recommendations included in the consensus report reflect the majority vote by members, it should not be implied that a recommendation carried unanimous consent by all members. Where committee members felt strongly about particular measures or approaches to implementing the recommended policies, those views are contained in a section of the report entitled "Minority Views."

Our findings and recommendations emphasize concentration and its effect on competitive conditions in livestock and poultry markets from producer to consumer, in railcar allocation, and in areas in which concentration introduces or aggravates other social concerns, such as the vitality of rural communities or their quality of life.

We understood the charter to provide for a breadth of investigation that was, essentially, limitless. In reality, however, we did not anticipate that a thorough review of all aspects of concentration would be possible in the timeframe allowed. An omission of any area should not be interpreted as a dismissal of concerns expressed in public testimony before this advisory committee or in

other places. We are particularly concerned that the constraints of time and resources under which we conducted our review did not permit a more thorough evaluation of the impact that wholesale and retail meat markets have on livestock producers.

Part II of this report summarizes the context in which we reviewed agricultural concentration and its implications for producers, consumers, markets, and rural communities, with particular regard for the cattle and beef sectors.

Part III reports findings as they were developed from public testimony, the evidence available and considered by the committee, and our review of the USDA-commissioned study on *Concentration in the Red Meat Packing Industry*.

Part IV presents the committee's recommendations related to the livestock and poultry sectors. Part V presents the committee's findings and recommendations with respect to the area of railroad consolidations and railcar shortages. Part VI contains views presented in a minority report.

II. BACKGROUND

Perceptions & Concerns About Concentration

Concentration relates to a condition in which a few firms possess a large share of the industry or market. *Firms may dominate by being few in number*, relative to the overall market in which they operate, *or by sheer size alone*. Concern for farm markets usually occurs when there is a significant trend toward increasing concentration over time. Growth of marketing firms in a vertical dimension may not increase concentration, but may still raise concerns. And, multinational linkages may lead to larger firms without increasing market concentration. Nonetheless, all of these patterns of industrial restructuring which lead to increased market shares or larger firms are concerns because they are frequently perceived to alter the power balance between farmers and the marketplace--to the disadvantage of farmers.

Without doubt, there are benefits associated with large firms in the marketplace. Many, though not all, of the benefits of large firms accrue to consumers rather than to farmers. Yet, if they are important, they must be taken into account when making policy recommendations.

In the last two decades, focus has shifted to our balance of trade and the ability of our agricultural and industrial complex to compete successfully in a global economy. In this context, larger firms that possess the resources to be innovative in product development and marketing often bring advantages that enable them to successfully compete in global markets. Large firm size can also capture significant economic efficiencies that lead to cost savings and lower prices for consumers.

Within food industries, product innovation has grown in importance. Products are adapted and adjusted to better fit changing lifestyles and health needs, and we possess both the science and physical capability to distribute food products in nearly infinite ways. And, while innovation can originate anywhere, the costly reality of introducing new products into food markets means that most new products--whether food or manufactured goods--are introduced by large, and more often than not, multinational firms.

Regardless of the benefits of large firms--in the context of global markets and the obvious consumer benefits that accrue--concentration has been a focus of concern down through history. Classic economic theory has articulated a pattern of monopoly behavior in which a large seller, in control of a market, is motivated to restrict output and increase price in order to maximize profits. Where most of the market is held by only a few sellers, their motivation to collude or "work together" to achieve some of the monopoly advantage is well documented.

In commodity markets particularly, where farmers face these large multinational firms, concentration is likely to have its most significantly adverse consequences. Farm producers find themselves facing processors or manufacturers in very concentrated markets, who have incentives to expand because of scale economies in consumer products. This situation offers incentives for collusive price behavior at worst, and for diminished information flows at best. Where information concerning prices is not easily available or accessible, uncertainty and anxiety often translate into hostility and distrust.

In U.S. history, the concentration of economic power has drawn very special policy attention. Early American policy makers, fleeing concentrated political and economic power in Europe, purposely chose to emphasize the rights of individuals and constrain institutionalized power. Thus, it is not surprising that a vigorous antitrust policy developed to a much greater extent in the United States than in European countries.

Yet, after nearly two centuries of being generally well accepted as the benchmark for unacceptable

market behavior, controversy has developed. As we move to competing in a global marketplace, we frequently find monopolistic behavior to be subtle and not easily verified. Advantages of large firms now seem more important in international competition, while regard for small, domestic firms seems to have declined. In addition, the apparent effectiveness of public agencies also may have declined. In light of these factors, the historical pattern of antitrust enforcement has come to be regarded as a less powerful force in detecting and modifying anticompetitive behavior.

Current Situation in Livestock & Meat Sectors

While much of the U.S. agricultural economy is prospering in an era of high grain prices, cattle prices are severely depressed--the first major downturn in almost 10 years--with prices to producers at record lows in constant dollars. Record-high grain prices, coupled with large supplies of competing meat products, are also contributing factors to current low cattle prices. As distressing as this period is for producers, however, there is still no evidence that this cattle cycle is significantly different from other cattle cycles.

On the other hand, packer returns are high, following 3 years of depressed levels. In the last 3 years, according to *Feedstuffs* magazine, packer profits have grown from a loss of $3 per head to profits of $8 and $24. Packer concentration continues to increase, reaching a current level of four firms slaughtering about 80 percent of the fed cattle in the United States and an increasing percentage of nonfed cows and bulls. Concentration has begotten concentration, with the elimination of traditional wholesalers and the increasing influence of large retail beef buyers. On the supply end, according to the *Concentration in the Red Meat Packing Industry* study, feeders have likewise grown to a point where 152 sellers, or less than 1 percent, accounted for over 40 percent of all head sold.

Other sectors of the meat distribution industry have also suffered through a period of depressed earnings. But their period of low earnings occurred while cow/calf returns were high: supermarket net returns on sales fell to one-half their normal levels in 1992-93, while producer returns were at their peak. In 1995, net profits returned to 1 percent of sales, but only after a period of painful adjustment.

Meanwhile, retail beef prices to consumers have remained relatively stable in recent months. Numerous expressions of concern about abnormally wide price spreads and margins were provided to the committee. According to USDA's Economic Research Service (ERS), Choice retail beef prices have not yet fully adjusted to recent declines in farm prices. Historical evidence suggests that retail beef prices typically adjust to changes in the net farm value with a lag of many months, but downward retail price adjustments occur more slowly than upward price adjustments. No new or unusual patterns in inflation-adjusted price spreads have been identified in recent months. According to ERS, the relationship between net farm value and Choice retail price since October 1994 does not appear to be statistically different than the relationship that existed from 1979 to the fall of 1994 (based on available data).

Changing Market Forces

Economic hardship and painful adjustments are not unique to those farmers and ranchers now in difficulty. Neither are economic hardships and painful adjustments in today's environment unique to agriculture. Yet, dramatic and dynamic changes are taking place in today's markets for livestock and meat products, and those changes inevitably bring difficult adjustments.

Consider the following statement about business across the entire scope of our economy:

"The world is becoming a global shopping mall...This puts the power of choice in the hands

of customers, changing the terms of competition forever...No business, however locally focused, is immune from these changes, because they rattle the supply chain. Smaller businesses feel the impact of globalization through the demands of their customers, who want the world's best quality, extra services, and closer partnerships with fewer suppliers. So companies need global mindsets whether or not they seek global markets." [World Class, Rosabeth Moss Kanter, Harvard Business School, Simon & Schuster, 1995]

Today, meat products of all types, and beef products in particular, move increasingly innoncarcass forms. Perhaps the most important and dramatic example is the very large fast-food hamburger industry, buying and merchandising primarily ground beef. Even in the supermarket sector, prepared or partially prepared foods are rapidly gaining market share, shifting buyers toward boxed beef and value-added beef products. This means that an information reporting system built on the movement of whole carcasses, or designed to reconstruct carcass prices, is increasingly out of touch with reality.

This new marketplace, where a minimum of processing is done in the retail establishment, indeed even in the home, places a premium on delivering consistent product quality geared toward tighter and tighter buyer restrictions. This in turn places a premium on various contracting arrangements, all the way back to the cow/calf operator, to improve consistency and efficiency beyond that which can be accomplished with average price signals alone.

In understanding the changing market for meat products, trends in international trade are also important and will have influence on policy recommendations related to concentration. Cattle movements across U.S. borders, for example, may exacerbate a domestic oversupply situation if cattle coming into the United States compete with domestic cattle for slaughter demand.

Meat imports and exports are a permanent and growing reality. Agricultural trade is important for the total U.S. balance of trade and for helping our Government to open markets for nonagricultural products. Since exports and imports often involve very specific cuts or specific parts of animals (chicken feet or dark poultry meat, to take two non-beef examples), the balance of carcass proportions consumed within the United States is changed. In other words, whole animals or whole carcasses no longer need to be accounted for by domestic consumption alone.

In addition, since importing meat products is increasingly easy to accomplish, the very real potential exists for production to move out of the United States if unrealistic conditions are imposed on any element of the domestic industry. Care must be taken not to provide incentives for this to occur, because that could cause permanent damage to the producer community.

The Current Environment Breeds Distrust

The current environment and the forces shaping that environment, however legitimate, have spawned a breeding ground for distrust and suspicion. Distrust is fueled by the great and increasing concentration of the industry. Every major antitrust law has been the result of packer concentration, and the previous levels of concentration which spawned governmental action were much lower than those which now exist.

While the pursuit of efficiency can lead to concentrated industries, competition may ultimately be sacrificed. Competition in the long run is more important than efficiency in the short run. Left unchecked, single-minded pursuit of efficiency can lead to concentration and market power that first destroys competition, and then efficiency itself. Concentration on one side of the market tends to foster concentration on the other side of the market. And, concentration may also tend to encourage adverse environmental impacts.

There is no indication that the concentration process will slow or stop in the near future.

Indications of continuing growth in market share can be found in the public statements of intention by the packers themselves and in the upward trend on concentration graphs. The effects of the concentration in the fed beef market are magnified by the concentration trends in the cow/bull market, the pork industry, and elsewhere along the meat production chain.

Producer distrust is likewise based in the absence of information upon which to base production and pricing decisions, or in misinformation about packer behavior. The price reporting and discovery process is a relic of days gone by, when almost all livestock went through terminal markets and prices were arrived at by open and competitive bidding. Today, less than 2 percent of fed cattle go through that price discovery process. The rest are either held as captive supply or bought by ever-decreasing numbers of competitors on transactions at the feedlots or ranches. In the absence of accurate and immediate information, some producers infer that they are being taken advantage of by large firms assumed to possess superior information and control of the demand for the producers' products. It is of the utmost importance that information about market conditions and trends be widely available to sellers and buyers at ***all*** levels of the industry.

III. FINDINGS OF THE COMMITTEE
Livestock, Poultry, and Meat Sectors

Public Testimony

The committee heard testimony from over 70 individuals and organizations, representing producers, processors, wholesalers, rural communities--their families and businesses--environmental groups, and animal rights groups. In addition, hundreds of pages of written testimony and correspondence were submitted to and reviewed by the committee.

Two powerful messages were conveyed in testimony before the committee. First, producers feel powerless to address their problems in the closed concentrated systems with which they must deal, particularly within the cattle industry. Of course, there is a cattle cycle, and ranchers have always lost money at some point in that cycle. Now, however, the losses seem out of control and hard to justify in light of the record profits being recorded at the higher levels of the beef industry. Given the mounting losses producers face, it seems likely that some producers will be forced to exit the industry.

Second, the depression of producer prices at all levels, particularly for cow-calf operations, is devastating not only to producers but to all whose lives revolve around cattle production. The South Dakota witnesses painted a picture of rural communities losing businesses, schools forced to close, State revenues in decline, and families being forced from the land their families settled long ago.

Public testimony conveyed the following points on concentration and various marketing arrangements used in the market, including captive supplies and formula pricing, vertical coordination, and vertical integration:

• Distrust of the current procurement system is real and significant. Many producers expressed distrust of meatpackers and said other producers were afraid to testify because they feared reprisal if they did so. There is widespread belief in excess packer concentration and in the use of this concentration to depress prices paid to producers. There is similar distrust in the functioning of the rest of the distribution system, but the clearest focus of this distrust is at the packer level.

• A significant number of producers believe formula pricing, captive supplies, and various forms of vertical integration lead to thin markets and the potential for price manipulation, to the detriment of farmers and ranchers.

• Testimony from contract growers offered dichotomous views. On the one hand, testimony was offered that various forms of vertical integration or contracting provided financial stability, reduced risk, and the ability to attract loans from financial institutions that allowed them to stay on the farm or to enter the production market for the first time. It appears that in those regions of the country where integrators are in competition for contract growers, the terms of the production contracts are more generous than in areas where a single integrator predominates.

• On the other hand, vertical integration trends raise at least two very important long-term issues: 1) an imbalance of power between the integrator and the producer, and 2) environmental problems associated with the extreme concentration of animal and processing waste.

• The committee heard from a large number of producers as well as from farm organizations representing a broad ideological spectrum that the information on prices and terms of trade is insufficient for many producers. A recommendation was advanced for far greater disclosure of such information by both the buyer and seller. The committee also received testimony that the appropriate agency maintain "time-specific data" to provide for retrospective

monitoring to assure that firms do not manipulate markets.

• In particular, a significant number of producers feel that current trade data is woefully inadequate in meeting their needs for timely and accurate reporting of meat import and export information. The committee heard from a number of individuals and organizations that by the time export data is received, it is out of date and useless. In the grains, export sales are announced to the trade on a daily basis. While such a system may not be workable for meats, the current protracted delay in reporting export data was thought to give advantage to buyers in their negotiations with sellers of livestock.

• A significant number of cattle producers are now in severe financial difficulty. The same is true to a lesser extent for other meats.

• A significant number of producers feel inadequate attention has been paid to the impact of producer hardship on local communities, schools, and churches.

• A significant number of producers feel that new production and processing methods damage the environment and degrade the quality of life in rural communities.

Other Evidence Considered by the Committee
The committee has access to a large volume of government studies, academic studies, trade association studies, and basic data, in addition to public testimony from citizens and experts. We have not done original studies of our own. In this section, we present findings which represent our understanding and assessment of issues which we see as important matters.

On matters of *industry structure*, where public data is frequently reported and widely understood, our findings are not hugely complex or controversial. However, where the *behavior* of firms is at issue, our findings must rest on much less formal information. Here, we indicate our assessment of the issues based on statements of contributors at public hearings and the judgment of experts we have invited to contribute, together with our understanding of the economic studies we have reviewed. Our findings represent our best judgment of where truth lies, based on the best information we were able to assemble.

In general, evidence of growing concentration in all industries (not just agriculture) suggests that increased vigilance is necessary to monitor the economic and possible social consequences of that concentration. With particular regard to agriculture, while the bulk of the evidence indicates that increased concentration in the agricultural industries has not been accompanied by overt or obvious market power and the extraction of monopoly or monopsony profits, the potential and opportunity for doing so are increased.

The committee notes the following general points as findings, based on evidence from all sources that have been reviewed and considered:

Levels of concentration
• Major differences exist between the beef, pork, lamb, and poultry industries. Specifically, the industries significantly differ with respect to their structure, marketing and pricing systems, biological capabilities and limitations, business practices, and current levels of industry cooperation, concentration, and coordination.

• Distrust of the current procurement system is real and significant. There is widespread belief that packer concentration is excessive and that this concentration has been used to depress cattle and sheep prices.

• The level of concentration is historically high and growing higher in many areas of the agricultural economy, including meat packing, as well as in several food industries. The merger movement of the past decade has contributed to the increasing concentration throughout the agricultural economy. This concentration

provides the opportunity to both use and abuse market power.

• In meatpacking alone, concentration has risen to the point at which four firms account for over 80 percent of all cattle slaughtered.

• In the lamb industry, three firms currently control approximately 70-75 percent of the market, with no clear fourth-place firm. The trends of high concentration exist not only at the packer level, but also at the processing (or breaking) level. This trend of concentration has never been thoroughly evaluated, nor is it clear how the interrelationships--from the lamb packer to the breaker--are established anymore. In 1995, the largest lamb packer ceased operation of its fabrication floor. Within 2 weeks, the largest lamb breaker established operation at the plant. Currently, both the packer and the breaker claim little actual input into the other's operation.

• Recent sharp declines in cattle prices are partly attributable to supply and demand conditions. But there is a growing and discomfiting sense that these market price declines extend beyond those attributable solely to ordinary market forces of supply and demand.

• Meat packers sometimes make an offer of a higher than market price on the condition that the higher price "not be reported." This action is a price manipulation because it would affect prices offered to other sellers. However, it is very difficult to verify this practice and its frequency.

Concentration & information access
It is widely agreed that equal and accurate market information improves the price discovery and determination process. Poor information can lead to unnecessary price volatility or slow adjustment to changing supply and demand conditions. Inadequate or uneven information can cause some market players to be disadvantaged relative to others, and some suggest that price levels could be biased for an extended period. Although quantifying the price effects and determining the public and private costs and benefits of information policies are extremely difficult, the committee heard considerable testimony that the lack of timely information is a significant concern of producers--particularly smaller producers.

Do smaller sellers receive lower prices than large sellers, for example, for cattle of the same characteristics? The *Concentration Study* provides an inadequate basis for answering this question because it aimed to assess the general state of competition in the market, not the extent of price discrimination. What price discrimination may exist, according to the study, is likely limited and not more than a 5-percent difference, because the price data collected appear to be narrowly distributed around their average. Still, it is possible that some sellers are receiving prices that are below those received by better informed sellers.

Captive supplies & marketing arrangements
• Captive supplies and other forms of vertical integration and coordination at levels in which they occur--in some regions and at some times of the year--are potentially detrimental to both competition and price discovery. These arrangements have a tendency to thin market price reporting (reduce the volumes on which reported prices are based) and shorten the weekly marketing "window," which can disadvantage suppliers who do not have a packer arrangement and distort reported market prices downward.

• It is nearly impossible to identify how many lambs are actually available at a future date because of the lack of on-feed data. However, packers know what they have forward-contracted in advance and, with little known about available supplies, packers may have a competitive advantage when entering into price negotiations for open market delivery. Smaller lamb producers without access to the same information are at even more of a disadvantage than larger, well-connected feedlots.

• Vertical integration and concentration are not only factors in the livestock market, but in the meat market as well. Packers have increasingly assumed functions that were previously undertaken by independent processors; wholesalers; and agents, brokers, or commission merchants.

Evidence on captive supplies from the *Red Meat Packing Concentration Study*
Based on data collected by the Grain Inspection, Packers and Stockyards Administration (GIPSA) for the USDA-commissioned *Concentration Study*, large sellers are far more likely to participate in captive supply arrangements than small sellers. Nationwide, about 300 large feedlots (more than 16,000 head sold in a year) accounted for 82 percent of all marketing agreement transactions in the database, 89 percent of packer-fed transactions, and 56 percent of forward contracts. Those large feedlots handled 42 percent of all transactions and 57 percent of all cattle in the transactions. By contrast, over 17,000 small sellers (those selling less than 1,000 head each year) who accounted for 22 percent of all transactions, 13 percent of all cattle sold in the transactions, and 88 percent of all sellers were much more likely to use spot markets. Small sellers accounted for only 1.6 percent of packer-fed transactions, 2.6 percent of marketing agreements, and 15.2 percent of forward contracts.

Cattle obtained under forward contracts bring slightly lower prices than cash market cattle with similar characteristics; prices are lower to producers because forward contracts reduce producer price risk. The price difference in the data analyzed was about 2.5 percent on average.

On the other hand, cattle procured under marketing agreements brought slightly higher prices than those obtained through cash markets, with an average difference of less than 1 percent. Higher prices would be expected if slaughterers were to use marketing agreements to procure cattle of higher quality or to lower processing costs.

Packer-owned cattle showed no price differences, but this price data is unreliable, since no actual market transactions are recorded.

USDA's authority under the P&SA
A number of findings are suggested by a review of GIPSA's authority under the Packers & Stockyards Act (P&SA). Those findings include:

• There are a number of actions that the P&SA is intended to address before actual harm is so severe it can be documented. The Secretary's mandate under Section 202 is to address abuses of market power "in their incipiency," before harm has been done or can be documented by studies. Even more important, that mandate is proactive: it is to ***induce*** healthy competition, not merely to react to unhealthy competition. It is to ***assure*** fair trade practices, not merely to prevent unfair trade practices. Such a mandate provides more authority to protect and enhance marketplace competition than can be found in the more limited areas of antitrust and unfair trade practice law.

• While many provisions of antitrust law require proof of intent to monopolize, Section 202 of the P&SA clearly addresses behavior that has either the purpose or merely the effect of controlling prices, creating a monopoly, or restraining commerce.

• Moreover, the Secretary's authority to devise ways and means of achieving the Act's objectives are sweeping. The legislative history of the Act suggests that the Secretary has enormous discretion to devise regulations to achieve the Act's purposes, regardless of technology, market structure, or other conditions that might develop. This section gives the Secretary authority to mandate reporting and disclosure to the public of vital market information without additional Congressional action.

• The Secretary's recent actions to enforce Section 202 against a meatpacker alleged to have offered an undue preference to a cartel of cattle feeders in Kansas is appropriate, inasmuch as it represents commitment to enforce Section 202 of the Act. (We make no finding with respect to the merits of the allegations involved in this specific enforcement action.)

• GIPSA and USDA have insufficient legal and investigatory resources to enforce Section 202 of the Packers and Stockyards Act.

• The *Concentration Study* by itself is an insufficient basis for policy making because of the data inadequacies in major portions of the study, including the timeframe within which the data was gathered. Moreover, the crucial section of the report addressing the central issue of whether concentration affects prices was inconclusive for methodological reasons.

Evidence on Vertical Linkages

The committee heard and reviewed a substantial body of evidence related to the beneficial and negative aspects of vertical coordination and integration arrangements emerging in agricultural subsectors. Vertical integration has already transformed the poultry industry into a very efficient production system. It has also increased the horizontal concentration in the poultry industry. Vertical integration will likely affect a large share of hog production within the next decade.

Benefits of coordination include improved risk management, efficiencies in production and distribution, opportunities for traceback to assure safety and quality of output, and the ability to respond specifically to consumer demands. Given an expected continued increase in both standards of living and ethnic diversity of consumers, the trend toward product diversity will continue. Hence, the drive toward more coordinated production to ensure satisfactory product diversity that meets consumer demands is likely to increase as well.

Coordination to manage risk

Risk has been a hallmark of the agricultural sector, and business strategies to reduce risk have significant structure and coordination implications. Risk arises from a number of sources, and risk management strategies include: 1) contracting for supplies to reduce the risk of high prices for inputs; 2) contracting product sales to reduce the price risk exposure on products; and 3) reducing price risks by vertically integrating into the input supply or product distribution channels. All of these strategies attempt to reduce the impact of market fluctuations that are part of the open market spot pricing system.

For example, in the sheep industry, contracting with a guaranteed price is one type of agreement becoming prevalent under current tight supplies, as feedlots and packers attempt to maintain market share. This type of contract eliminates risk to the producer. Another prevalent contract is based on one of a number of formulas, where the packer arranges for a certain quantity of product to be delivered, with payment to the feeder or producer based on prices received by the packer at a later date. This contracting shifts more of the risk from the packer to the feedlot or producer.

Regardless of who bears the risk, the use of contracts reduces the number of lambs being sold on the open market. During a tight supply situation, contracts may actually enhance prices for lambs remaining on the open market. In periods of heavy supplies, however, contracting may have just the opposite effect--tending toward lower prices for lambs sold on the open market.

Coordination to manage capacity & quality

Food packaging and processing unit costs have become very sensitive to operating at full plant capacity; thus, flow scheduling is critical to being cost competitive. Matching the physical capacity of various stages is critical to overall efficiency of the system, and this type of coordination may be more difficult in open markets.

Furthermore, some food distribution channels may require particular quality characteristics which may not be available in predictable quantities in open, spot markets. The coordination needed to ensure both quality and quantity for efficient operations can be achieved through contracts, ownership of more than one stage, joint ventures, or similar arrangements in the food production and distribution chain.

Coordination to manage safety & health
Safety and health considerations in food production have become more serious in recent years. There are two dimensions--the health risk of foodborne disease and the risk of polluting water, air, and land resources in the food production processes. Both can result in significant direct costs and liability exposure not only for the responsible firm in the food chain but also for those firms that supply related inputs and purchase products from the "responsible" firm. Thus, system coordination to reduce or control these risks may be, in part, a response to the broad sweep of product and environmental liability law, as well as to concerns about destroying brand value or market position because of a food safety problem.

Social costs and vertical linkages
Without doubt, industrialization in agriculture has lowered the overall costs of production as reflected on the participants' balance sheets. However, concentration--particularly as evidenced in vertically integrated operations--can also lead to additional costs and risks which are not always fully reflected on the income statements or balance sheets of industry participants. In particular, social or external costs arise which may not be appropriately reflected in output costs and prices to consumers.

Environmental Issues The increasing size of livestock operations and processing plants has led to growing public concerns about environmental effects associated with these large scale facilities. A number of States--including North Carolina, Missouri, Iowa, and Minnesota--have experienced large-scale pollution incidents associated with large hog confinement units. Iowa forbids packers to own swine, to guard against the gradual monopolization of its important industry.

While pollution and odor have always been problems with livestock farming, the corporate face exacerbates the neighbors' problems. First, with the large size of these operations and lagoon storage, the smell is greater, both from storage and disposal. Second, owners do not always live on the farm and share the problems as do traditional farmers. Water problems are similarly exacerbated by vertical integration. In some States, large operations must meet permit requirements for lagoon standards, available acreage for land spreading and other requirements designed to reduce the probability of an incident's occurrence. Still, any incident involving a very large facility will have effects far beyond similar incidents at smaller operations.

Packing plants raise similar concerns. Prior to the consolidation of the packing industry, the establishment of a packing plant was welcomed by community leaders for the job creation it brought and the market it provided for area farmers. Now, with the lowering of the industry's wage structure, the demands on a community's infrastructure, and the social needs of frequently imported laborers, the prospect is far less desirable. Indeed, one Minnesota city recently said "no thanks" when a new packer proposed to open its doors there.

The social implications (both negative and positive) of concentration are important, and this report cannot do them justice. The job of government policy at all levels is to assure that social costs are appropriately reflected in the price of the product which generates them. Through legislation and regulations, USDA must take action that ensures the proper functioning of a competitive economy. The relevant environmental, taxing, and land use agencies at all levels of government must enact measures to assure that externalities are reflected in the production costs of concentrated livestock production and

processing. And the information provided by these agencies must be equally and immediately available, as discussed elsewhere.

Role of Credit & Lending in Concentration

One aspect of concentration that is often overlooked relates to the role of lenders in concentration. In today's agricultural economy, the availability of credit often determines whether a farming or processing operation can continue.

Some farm lenders have adopted the view that mere continuation of a viable family farm enterprise is insufficient reason to grant operating credit. These lenders have assumed the role of farm manager and long-range planner, forgetting the lessons of the past two decades. Farmers who have made decent livings and survived the 1980s farm credit crisis are now refused operating loans unless they agree to expand. For these farmers, the price for survival is taking on excessive debt and expanding to factory farm size.

By granting credit only to large-scale operations on the basis that such operations are the future, these lenders will create a self-fulfilling prophecy. The only operations that will survive will be big operations, not necessarily because of increased efficiency, but because of their access to capital.

IV. RECOMMENDATIONS

Livestock & Poultry Sectors

Objectives & Guiding Principles

A number of objectives or guiding principles should undergird the recommendations made with respect to livestock and poultry sectors. Specifically, recommendations should:

• Promote competition;

• Achieve, as close as is possible, equal market information for buyers and sellers; and

• Assure that markets exist for all comparable products under comparable terms.

The committee was also mindful to avoid recommendations that proscribe market behavior in ways which could ultimately stunt opportunities for growth within the industry. Recommendations should improve the functioning of markets, and not, in the words of many committee members, "tear down industry." In this regard, the committee endeavored to:

• Focus recommendations in those areas of long-term significance and those areas of most immediate need to producers;

• Recognize the distinctions and major differences among livestock and poultry sectors, and refrain from blanket recommendations for one species that could have serious, unintended consequences if applied to the entire meat industry;

• Take care not to overreact to the normal functioning of the cattle cycle already entering the adjustment phase, leading to lower supplies and higher prices; and

• Refrain from making recommendations that would slow or prevent the industry's need to adapt to a changing marketplace.

The committee is also aware that, in making recommendations to improve markets for producers, effects on consumers must be considered. Some of the recommendations may, in fact, show short-term price increases to consumers, since in a current battle to achieve market power, firms may be willing to cut prices and sacrifice short-term profits for market share. Recommendations that thwart the use or dilute the value of this strategy could lead to higher prices in the short run. However, maintaining competitiveness will pay long-term dividends to consumers by assuring a safe and reliable food supply, without monopoly premiums that are ultimately paid by consumers.

In light of these considerations, the committee recognizes that many of the recommendations are likely to bring increased costs, and that timing may need to be a consideration in their implementation. Despite these cost and time considerations, the committee feels that the benefits of improved market performance justify their adoption and implementation.

The committee is very concerned about the distrust between segments in the cattle industry. The recommendations offered below should help in this regard by promoting efficient price discovery, thereby helping to restore confidence in the market. With specific regard to adequate and accurate reporting of market information, the committee believes that efficient and fair marketing information can be obtained without causing undue burdens on reporting parties. Situations with many sellers and few buyers may require greater availability of information than would otherwise normally be forthcoming, and such information availability helps to ensure competitive markets. Fewer buyers would be unable to exert undue leverage if market information were widely available to more dispersed sellers.

However, notwithstanding recommendations that are more market based in their approach to

improve market performance and confidence, existing antitrust and regulatory tools should not be abandoned. The committee believes these tools can and should be effectively used to prevent or stop anticompetitive behavior of firms.

With these objectives and considerations in mind, the committee makes its recommendations in four areas: a) antitrust and regulation; b) a new disclosure policy; c) vertical linkages; and d)cooperatives/producer bargaining. Recommendations may overlap across these broad areas. This simply reflects the overlapping nature of many of the issues related to concentration in the marketplace.

A. ANTITRUST & REGULATORY ACTIONS

We have considered a number of actions within the framework of our legal structure and tradition of antitrust policy, including the special provisions of the P&SA. The following are recommendations of the committee dealing with antitrust and regulatory actions:

Increased monitoring and enforcement of antitrust and regulatory policy

A.1. Antitrust enforcement of current regulations under the P&SA should be stepped up. Any new mergers and consolidations that have the potential to reduce competition should be quickly challenged by the U.S. Departments of Justice and Agriculture. If any consolidations or strategic alliances are challenged, the contracting parties should be required to show that existing laws are not being violated, and that further concentration will enhance and not diminish competitiveness within the livestock industry.

A.2. The committee supports the position expressed often during the public testimony to "just enforce the laws." The P&SA provides authority to deal with unfair trade practices, under Section 202, which states that, "it shall be unlawful for any packer with respect to livestock, meats, meat food products, or livestock products in unmanufactured form, or for any live poultry dealer with respect to live poultry to: make or give any undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever." It should be enforced to the letter of the law.

A.3. Congress should appropriate sufficient resources to USDA to allow aggressive pursuit of violations of the act and address problems in their incipiency.

A.4. As to enforcing the laws as they now exist, the Secretary should immediately undertake a review of current enforcement practices and publicly report the results of that review. This would help restore the confidence of producers that their interests are important and protected adequately.

A.5. USDA should expand the private right of action to parties believing themselves to be damaged by violations of the Packers & Stockyards Act and its regulations. While a certain right exists, to make the law fully effective, especially at a time of shrinking federal resources, a right to attorneys' fees should be provided.

A.6. GIPSA should investigate lamb supply contracts for their impact on markets and market access for participants without a supply contract.

A.7. USDA should ask the Antitrust Division of the U.S. Department of Justice for a report (confidential) about their findings to date on the question of packer concentration, including the lamb investigation of the 1990s. If their disclosure reveals the need for investigation, it should be done.

A.8. Congress should amend the P&SA to provide the Secretary with the same administrative and enforcement authority in all poultry products

as in red meat, including all growers who raise and care for live poultry for another entity.

Limiting packer activities

A.9. Price differentiation should only be permitted with respect to differences in quality, verifiable differences in procurement costs (including differences in cost due to quantity), and time of delivery.

B. MARKET-BASED DISCLOSURE POLICY

As we have stated above, the committee endorses the message widely repeated in public testimony to "just enforce the law." Over and over, the committee heard from individuals who compared conditions of the early 1920s that gave rise to the Packer Consent Decree and the Packers and Stockyards Act, with market conditions today, with no comparable antitrust action being taken.

Of course, we realize, as do these individuals, that the marketplace of the 1990s is not the marketplace that prevailed in the 1920s. Structure, technology, and the marketing system are vastly different: markets are global in scope, and marketing strategies are increasingly complex. Government resources are limited, and certainly not expanding. In today's environment, antitrust actions have become much more complex and burdensome. Antitrust violations are more difficult to identify, or in some cases, to define. Massive amounts of records must be collected in the pursuit of an antitrust case, partly because it is not clear what information is needed. Firms are better able and more willing to mount a strong defense.

All of these factors mean that antitrust enforcement operates in a far more challenging environment than in the past. It is not that the standards of unacceptable market behavior have been relaxed; but building the case for unacceptable behavior has become more difficult.

Moreover, the complexity of initiating and successfully bringing an antitrust investigation to closure creates perceptions of the Government as a micro-manager of firms, and contributes to a hostile business-government relationship. In today's global market, no country can afford a climate of distrust and hostility when successful global competition often depends on productive, industrial partnerships between government and business.

We conclude that antitrust policy would be more positively and effectively enforced if anticompetitive practices and behavior were more transparent and visible. Scarce resources and opportunities for productive government-business relationships would not be wasted in investigations that eventually wither for lack of evidence--or worse, because they were unjustifiable in origin. Thus, we propose a more innovative approach to addressing concentration--a market-based disclosure policy.

Carefully implemented, a disclosure policy offers several opportunities to address concentration issues in positive ways. First, a disclosure policy can provide a basis for harmonious and productive interactions between the food industry and farmers, as well as consumers. By itself, this would significantly reduce the distrust, anxiety, and hostility present between many segments of the market. Second, a disclosure policy is more consistent with other, current policy initiatives to facilitate efficient marketing and be results-oriented. Finally, and importantly, disclosure makes the unfair use of market power against farmers more visible, easier to observe, and therefore, more effectively and quickly corrected.

A Disclosure Policy Precedent in the Food Industry: Nutrition Labeling

We recall a recent policy shift to disclosure that dramatically affected the food industry and its relationship with consumers. That was the shift from an early 1900s policy of food "standards of identity" to the present policy implemented by nutrition labeling. Standards of identity were useful to protect product integrity and, in doing so, safeguard the public interest against unscrupulous processors who might be motivated to reduce the amounts of the more expensive ingredients.

In recent decades, the combination of food science technology and changing consumer demands for a host of food attributes have brought the introduction of thousands of new product formulations. Changing concepts of nutrition increased demands for less sugar and fat; changing lifestyles have increased demands for convenience, shelf-life, and variety. It is simply not possible to draft and maintain a dynamic, useful (up to date) set of standards of identity to safeguard product integrity.

Rather than waste scarce resources trying to keep up with the fast-paced food industry by writing more and more "recipes" that become outdated no sooner than they are written, a new policy protects the public interest in food integrity much more effectively. Today, nutrition labeling helps ensure the integrity of food products in an open setting that promotes more harmony in the marketplace.

Nutrition labeling is based on a policy of disclosure. Quite simply, firms are required to disclose the nutrition of their product in a standard and comparable format. The public interest in the nutrition content of food products is left to market forces of competition and the firms' desire to be responsive to consumers' needs and wants. With open disclosure, any product (and firm) that is insensitive to the needs of consumers is very likely to draw criticism, certainly attention, from the press or consumer advocates. Public criticism and the potential loss of public confidence or support for a product (thus, market share) help to maintain integrity in this public interest area.

Guidelines for Implementing a Disclosure Policy

Specific recommendations related to the types of information that we believe would enhance market performance are offered in the following pages. Before listing those specific recommendations, however, we suggest some guiding concepts that would be useful in crafting a successful disclosure policy.

Mutual trust in terms of trade--A successful disclosure policy can improve the functioning of the food system and provide a basis for mutual trust and cooperation. In this arrangement, there is little place for secrecy concerning terms of trade between concentrated parts of the food industry and farm producers or consumers. We are aware that defining some terms of trade involves complexities and sensitivities to products and product quality.

We do not presume to settle all of these issues here, nor do we presume that our specific recommendations are all-inclusive. It will take time for the new policy to emerge, be developed and tested, and find support. The significant expertise within the Department can work out the complex definitions involved, as well as optimal procedures for collection and dissemination of information.

Where terms of trade are complex, new descriptions of terms of trade may be required--a quality identification system for beef, a weighted average retail meat price or salient components of

a poultry production contract. These concepts will evolve with experience.

Information reporting & access--Information on prices and terms of trade is critical to both buyer and seller for efficient functioning of market systems. Disclosure of price and terms of trade by both buyer and seller for market and contract transactions would provide information that both parties could use to evaluate the competitiveness of proposed transactions. Line of business reporting by packers and feedlots is another area where disclosure would significantly reduce distrust and improve market confidence.

Such open disclosure would make markets more transparent (e.g., all parties could "see" the prices being paid for various attributes). Reporting by both parties would also provide a mechanism for checking accuracy and reduce the incentives to not report accurately.

Key concerns are the right to privacy, the importance of unique information as a source of competitive advantage, and the negative impact that open disclosure might have on innovation and creativity. Problems of privacy might be resolved with increasingly more sophisticated electronic data retrieval and manipulation systems.

In this area of information access, one of the most efficient ways to accomplish transaction transparency is through the implementation of an electronic marketing system. Before this can be done, however, the operating system of the electronic market must be designed and accepted by government and industry. This is not something that can be done quickly, but it is the understanding of this committee that this direction is a superior choice for the long run.

With these guidelines and objectives in mind, the committee makes recommendations for disclosure in the following areas:

Improvements in collection & reporting

B.1. As part of a new reporting process, contract or formula pricing premiums and discounts, based on carcass merit, should be captured and reported. To the degree that contracting improves plant utilization efficiency, and to the degree that contracting allows improved carcass merit to be captured, premiums will tend to be paid over the cash market. The resulting average prices currently reported will, therefore, understate the actual value of livestock slaughtered in any given week.

The addition of quality factors to the price reports, as suggested in this recommendation, will correct this deficiency. This addition will also result in improving the transmission of quality incentives back from the retail level, creating new producer incentives for improved breeding and management programs.

B.2. Research the reasons for and sources of economic difference in the value of market hogs--size of load, volume of annual business, timing of delivery, arranged time of delivery, plant operation economies, leanness, genetic line, etc. USDA should play a role in explaining the magnitude and sources of differences that exist. Engineering cost studies of packing plants or other research could add to the public's knowledge about differences in end-use value which arise from non-physical characteristics, such as delivery timing or supplier dependability.

B.3. Require timely, accurate price reporting for all packer livestock transactions. Reporting must include accurate, verifiable data on all captive supply. Responsibility should be equal upon both parties to the transaction; and penalties should be imposed for late, inaccurate, or misleading information.

B.4. Specifically, the committee recommends the following packer reporting: numbers of cattle purchased in the cash market on a daily basis; all captive supplies committed for delivery at the start of each week; numbers of forward-contracted

cattle in all out-months; Canadian or Mexican cattle committed for delivery at the start of each week; numbers and prices of cattle slaughtered on a daily basis; and exports on a weekly basis. For lambs, packer reporting of captive supplies for delivery is recommended at the start of each month.

B.5. For hogs, research and report on a quarterly or greater frequency, the proportion of farm-packer sales which are formula-priced by State or region. Such research would provide valuable information about the impact of formula pricing on the price discovery process. As the industry evolves, formulas may begin to be based on downstream markets, thereby making accurate, timely data on wholesale and retail price levels more critical to the farm pricing decision. To this end, USDA support for and involvement in cooperative industry efforts to improve product price reporting systems on the wholesale, sub-wholesale, and retail sectors will be vital.

Value-based pricing

B.6. Producers need help in comparing price bids among packers. A computerized decision tool which compares base prices and pricing grids would be of great benefit to producers. In addition, such a tool would allow producers to take advantage of geographic price differences that may occur and thereby reduce the effects of regional market power that exists or may develop.

B.7. The committee strongly encourages the Secretary to assist the beef industry in the development of a negotiated "grid" pricing structure, with the base price and spreads determined by competitive bidding between buying interests no more than 7 days prior to shipment. AMS Market News should report a value matrix for cattle on a weekly basis.

A similar price reporting mechanism, the "Lean Value Direct Hog Trade," is currently available for three regions to the pork industry. Indications are that these regionally reported value matrices have been well accepted by packers and producers as the primary mechanism for price/value discovery in the pork industry, and they may be resulting in a competitive advantage for the pork industry relative to beef.

B.8. Expand the producer price reporting pilot project for market hogs in Missouri to include other States and/or regions to represent a broader participant base. A producer price reporting system may be feasible with modern communications systems. Work with the industry to establish a standard leanness measurement as the industry's benchmark--such as the Fat-Free Lean Index. Explore ways to make differentiated prices more available nationwide and understandable to producers.

B.9. GIPSA should continue its long-standing work of monitoring the accuracy of carcass measurement equipment and devices.

B.10. USDA should develop a standardized list of premium or discount categories for carcass merit purchasing, and an additional list of premium or discount categories based on market arrangements (e.g., forward contracts, marketing agreements). These premium and discount categories may be used at the option of the packer as an aid in market communication. In addition, consideration should be given to reporting ranges as well as averages for each appropriate premium/discount category for livestock. This would improve the quality of market information now available.

B.11. We strongly support GIPSA's work with packers to review carcass merit pricing systems and changes to systems before their implementation, to assure fairness. Because some mistrust still exists between packers and producers about in-plant, packer-operated carcass measurements and items such as trim losses, the feasibility of third-party oversight of post-slaughter carcass evaluation should be reviewed.

B.12. The committee recommends that the volume of boxed beef price reporting be increased

beyond the current 36 percent of total steer and heifer boxed beef reported by the AMS Market News Service in 1995. It should include reporting of forward sales beyond the 10-day delivery period already reported, branded products, sales delivered as price basis to a futures contract, sales of less than carlot volume, and formulated sales. In addition to the currently reported Choice/Select price differential there should be a report of a price differential for USDA Prime and upper two-thirds of USDA Choice.

B.13. USDA should encourage the development of a close-trimmed boxed beef futures contract as an additional means of price discovery for the livestock industry.

Firm data & trade statistics

B.14. Line-of-business profits should be reported, for both packers and feed yards.

B.15. Import and export data for meat and meat products, including both price and volume information, should be made more timely and more accurate. Imports on feeder and fed cattle entering the United States should be reported, and information should be compiled and published regarding all exports of beef, veal, pork, lamb, chicken, turkey, and products thereof. The information should be reported within 1 week after the end of the week during which exports occurred.

Reports should include tonnage that is chilled, frozen, and the aggregate total tonnage exported. Reports should include tonnages of: a) carcasses and of each primal cut, reported by USDA grade where applicable; b) variety meats and processed meats exported; and c) exports to each destination (country) for variety meats, processed meats, and boxed primals, by USDA quality grade when applicable.

B.16. Develop better retail price reporting in order to more accurately reflect the farm-to-retail price spread.

C. VERTICAL LINKAGES

The trend to more negotiated vertical linkages in the food chain and the significant benefits in terms of cost reductions, quality improvements, and food safety of those linkages are real. But equitable sharing of the risks and rewards in vertical chains can be a serious problem--exploitation can occur.

C.1. One way to reduce this potential for exploitation is to make sure that all parties are well informed of their risks and rewards. The public role could be one of providing assistance to those negotiating a contract or other form of alliance to understand completely the financial and other consequences of the agreement.

C.2. Another approach would be to set up rules to "level the playing field" in negotiation of these linkages. These rules might identify, for example, what would be deemed "a priori" to be exploitative or inappropriate behavior (not unlike anti-redlining rules in lending or rules concerning sexual or racial discrimination in hiring) and the consequences thereof. Rules similar to those used in some States such as Minnesota, which indicate the penalties if a contract is breached without cause, might be implemented.

C.3. A related alternative could be mandatory sharing of information on costs, margins, and other relevant data between the contract or alliance partners, not unlike what is often shared in "due diligence" analysis in the cases of merger and acquisition activity. A key concern with this regulatory approach is that it has the potential to be a large bureaucratic morass and/or so burdensome that it discourages linkages and alliances that would otherwise have significant economic benefits.

C.4. Within the boundaries of making contracts more transparent, standardizing the terminology

used within contracts has significant merit. This would place both the contractor and contractee on even ground in terms of knowing what is being agreed to. Standardized terminology also helps define legal rights and gives the court system a uniform code from which to work.

C.5. With respect to social costs that arise as a consequence of integration--including costs associated with environmental, safety, and health considerations, the committee recommends implementation of consistent and effective rules for animal feedlots which address traditional water and air pollution problems along with odor. If technology is available to prevent significant negative environmental effects, it should be used. However, flexibility should be given to producers to achieve mandated environmental quality results through means of the producers' devising.

C.6. Since contracting in its various forms is now an integral and permanent feature of the meat procurement system, USDA should initiate an effort to explain to producers the terms of these arrangements, along with the potential advantages for both packers and producers. USDA should also provide some guidance as to how producers should make their decisions concerning whether or not to participate. This would remove much of the emotion now connected with these decisions, enabling producers to make more rational, informed decisions.

C.7. A rapidly growing percentage of livestock (hogs, beef cattle, and lambs) are sold to packers under marketing arrangements or contracts. Producers need to know what they must do to be part of future marketing arrangements. Specific contract terms are proprietary business information, but public knowledge of what is required to qualify for a contract will make for more competition for those contracts and, thus, make for an efficient market in future years. USDA should research and publicize what is required to get a contract. Public outreach by USDA on this issue would alleviate many fears of preferential treatment.

A supplier who can offer a steady supply of large numbers of uniform, high-quality hogs, for example, can command premium prices from packers. Independent producers can join cooperatives or networks to realize these gains and increase their competitiveness. Maintenance of the legal rights of producers to act through cooperatives and networks is vital. Specifically, packers should not be allowed to discriminate against producers organized to market animals.

D. COOPERATIVES & BARGAINING

Historically, agricultural cooperatives have been organized whenever producers believed they could gain advantages in the marketplace by joining together instead of buying or selling individually. There are many good reasons to support cooperatives. Cooperatives can provide beef, pork, and poultry producers with several very important benefits:

- competitive prices
- market access
- access to higher margin markets, including exports and value-added products
- risk-sharing marketing agreements
- a well-established and recognized brand name
- participation in the risks and profits beyond the production segment.

Unlike other types of business organizations, cooperatives are owned and controlled by their producer-members. This difference forces cooperatives to uniquely focus on the needs of producers. Cooperatives can effectively address many of the objections and concerns that producers have about the marketplace.

Fostering cooperative/collaborative behavior among producers, as well as between producers and those further along the food chain, has the potential to generate more value to be shared--it is

not necessarily a zero-sum game where one party can only gain if another party loses. There is less benefit in this collaborative approach in the commodity businesses and more benefit in differentiated product businesses. With the evolution of agriculture from a commodity to a differentiated product business, the payoff of cooperation/collaboration increases. But, if producers are not proactive, that payoff will be captured by others in the chain.

D.1. Enabling producers to bargain with first handlers and processors as a group and without fear of recrimination is a minimal public policy position. The right of producers to organize under the Capper-Volstead Act must be preserved. The processor or integrator should retain the right to deal individually with the grower whose performance does not meet the standards of his or her contract.

D.2. USDA has long promoted effective instruments of producer bargaining in many formats, especially marketing orders. We believe some instrument for the redress of producer grievances will eventually be required in large, integrated production and marketing systems like those in poultry and emerging in hogs.

D.3. Congress should amend the Agricultural Fair Practices Act of 1967 to require handlers to engage in good-faith negotiation with producer cooperatives and networks, and to purchase product from these entities without discrimination. As in the first recommendation, processors or integrators should retain the right to deal individually with the grower whose performance does not meet the standards of his or her contract.

D.4. Current laws should be reviewed to assure that there are sufficient safeguards to protect the rights of contract grower associations to bargain with processors to set the terms and conditions of production contracts.

E. OTHER AREAS

The committee considered and makes the following additional recommendations concerning other issues related to its charge:

Meat inspection

E.1. Urge USDA to take aggressive action in a timely manner to end the inequities in meat inspection. With regard to Federal and State inspections, the committee recommends that appropriate steps be taken to promote the ability of State-inspected packing plants that meet federal standards of inspection to compete by selling meat in interstate commerce. Provided, however, that such steps do not undermine the integrity of the U.S. position regarding acceptable inspection standards and safeguards for imported meat.

Trade policy

E.2. Speed up efforts by USDA and the U.S. Trade Representative to vigorously pursue and eliminate of the EU ban on U.S. hormone-treated beef.

Research

E.3. Urge USDA to immediately begin research for new technology to categorize beef by tenderness and implement instrument grading to measure other quality indicators.

E.4. Facilitate field testing and adoption of newly developed technologies like the tenderness-based classification system developed by Koohmaraie, et al., at the U.S. Beef Research Center, Clay Center, Nebraska.

USDA Programs

E.5. The former Farmers Home Administration, now part of the Farm Service Agency (FSA), and the lending arm of the Farm Credit Administration, including the Bank for Cooperatives, should focus their lending resources upon family-sized operations. If operating loan requests can be justified based upon continuation of existing operation scale, expansion should not be imposed as a condition for the extension of credit. USDA should be especially sensitive that resources appropriated under its authority not be used to subsidize large-scale operations.

V. FINDINGS & RECOMMENDATIONS ON RAIL TRANSPORT

Current Situation in the Railcar Industry
Railroads and the grain industry have periodically been plagued by grain car shortages (as well as surpluses) for well over a century. In fact, the first docket filed before the newly formed Interstate Commerce Commission (ICC) in 1887 was a car shortage case. Railcar shortages have occurred since then, but the most severe shortages were in the 1970s and since 1988.

Impacts of weather, market conditions, and mergers One cause of grain car shortages since the early 1970s has been dramatic increases in grain export demand over a short delivery period. The 1995/96 shortage is no exception. The U.S. harvested a huge corn crop in the fall of 1994--10.1 billion bushels. Large crop carryovers, combined with the 1995 crop, enabled the United States to capture increased export demand that materialized in late 1995 and early 1996.

U.S. grain exports rose 27 percent in 1995 over 1994, and another 2.3 percent in the first 3 months of 1996, compared with first quarter 1995. Total railcar loadings of grain were up 14 percent in 1995 over 1994, but down slightly--0.3 percent--during first quarter 1996 compared with first quarter 1995. Railcar grain deliveries to export ports were up 66 percent from 1994 to 1995, but down 1.8 percent in early 1996. Barge shipments of grain rose 25 percent from 1994 to 1995, but were down 6.7 percent in the first quarter of 1996 relative to the same period of 1995.

Even though grain exports have increased sharply, and both barge and railcar shipments to ports have increased dramatically, Upper Midwest grain shippers have suffered through an 8-month period of severe railcar shortages, and all of the frustrations that accompany those shortages. Railcar surpluses followed in other months of the year.

The extremely cold temperatures and heavy snows in January and February 1996 also hampered the ability of railroads to move grain during these months. All major grain-carrying railroads suffered declines in total traffic during the first quarter of 1996. Barges were similarly affected by the weather.

The 1995 flood in the St. Louis area also contributed to grain movement problems. The flood halted barge traffic for about 6 weeks on the Upper Mississippi and Illinois Rivers, thus delaying grain shipments. A huge 66-percent increase in rail shipments directly to export ports resulted in fewer trips per car. Grain shippers billed these cars directly to New Orleans, Houston, and west coast ports because of sharp increases in barge rates and barge shortages. These direct shipments took up to 3 weeks, compared to 2-3 days for a round trip to the Mississippi River for transfer onto barges. Cars that normally could have made 7 or more round trips between elevators and barge terminals, were now making only one trip every 2 or 3 weeks. Finally, large increases in export demand starting in late 1995--combined with the large carryover of the 1994 crop, the 1995 crop, and release of farmer-owned grain reserves--resulted in about 1.5 years' worth of crops moving out of the Upper Midwest in about eight months.

Car shortages have also arisen from difficulties attributed to rail mergers. Computer, labor, and management problems in consummating the merger worsened the railcar shortages. Trains sometimes sat on sidings waiting for crews or locomotives. Shippers were required to load trains in 15 hours-- even if it meant working at night, weekends, and holidays--only to have them sit for up to a week before a crew and set of locomotives would pull the train to its destination. In some cases, elevators waited up to 2 months before previously ordered trains were delivered.

Defining a car shortage solely from origin demand, without looking at unloading at destination, does not give a true picture of the logistical problem. A measure of unmet demand could be the number of ships on demurrage at grain export ports, such as New Orleans, which is served by both barge and rail. The market response by the different shipping modes may be a good indicator of what the real cure for car shortages is, for even when there are ships on demurrage, no barge shortage exists. The explanation is that barges, like trucks and ocean vessels, raise their prices to balance supply and demand. But railroads, because of regulation or political pressure, do not respond in the same manner. It is not impossible to eliminate car shortages. The problem is not just the seasonal nature of the business--barges, truck, and ocean vessels all deal in the same market--but one of pricing. Railroads need to be encouraged to price their services to the market in order to balance supply with demand.

Price differential factors Many shippers held much of their corn off the market early in 1995 in anticipation of higher prices. When the higher grain prices materialized, shippers tried to sell huge quantities of stored grain in a short time period, overloading the system and aggravating the car shortage problem.

Holding grain to maximize profits resulted in some elevators entering the 1995 harvest still full of grain. Some were even storing old crop corn on the ground before the new crop harvest began. These elevators had great difficulty obtaining enough railcars to even keep up with farmer deliveries during and after harvest, and were forced to pile even more corn on the ground. Anecdotal evidence suggests that many of these elevators suffered significant financial losses from increased interest costs, penalties for failure to deliver on time, and spoilage of grain from ground storage. Other elevators, on the other hand, that ordered cars early and on a consistent basis, were able to handle increased farmer deliveries and stored little corn on the ground. While not earning maximum per bushel margins, these elevators actually realized increased volumes and profits over the longer term.

RECOMMENDATIONS

It is difficult to totally eliminate car shortage problems, in part because of the seasonal nature of the grain business. However, the following recommendations are designed to help alleviate the severity of the grain car shortage problem. These recommendations are based on the principles of increasing grain car and locomotive supply, improving railcar productivity, and reducing the amount of grain that moves into the markets during short peak shipping periods.

Commodity Loans

The 1996 Farm Bill (Federal Agriculture Improvement and Reform Act) will continue to make marketing loans for corn and soybeans. Loans are for 9 months, and the bulk are released in September or October. USDA should consider moving grain under loan into the market over a longer period of time, rather than having most of it come to market at peak shipping periods.

1. The government loan period could be extended from the current nine months up to 15 months.

2. Alternatively, these loans could be arranged so that one-third of each producer's loans could mature at the end of 6, 9, 12, and 15 months. There could be different settlement prices or interest rates for each expiration date, as an incentive to release the grain at various times.

Financial Tools

Railroads, shippers, and private investors cannot afford to buy grain cars that will be used only to haul grain to export ports during peak shipping periods. Additional cars will be purchased only if

they are used more consistently throughout the year, at prices that will recover their costs, and give a return on the investment. This suggests that more consistent shipping throughout the year would motivate railroads and investors to purchase more railcars. There are many financial tools that farmers and shippers can use to maintain their income and still sell and ship more consistently over time.

These tools would improve farmer and elevator manager decision making on when to sell. This could be broadened to include not only margins on sales, but also expected demand, spoilage, penalties for late shipments, and additional interest costs from failure to ship on time.

There are many variations of each of these basic tools that can empower producers and elevators to bridge the gap between buyers' need for grain and the ability of the transportation system to move the grain. This means that both farmers and shippers need to understand how to use the available financial tools to coordinate buyers' needs for grain with railroad ability to move grain. Such tools include hybrid cash contracts, futures contracts, and options.

Various actions are needed to enable producers and shippers to understand how and when to use the financial tools described above to maintain their income and ship grain more consistently throughout the year. We believe that finding ways to maintain farmer and elevator income, by allowing grain to be transported more consistently throughout the year, offers the greatest promise for alleviating the grain car shortage problem at the lowest cost. In addition, railroads, shippers, and private investors are more likely to purchase additional grain cars if they can see a reasonable probability that the cars will be used more consistently during the year. The following are suggested:

3. An economic analysis is needed to determine the returns and risks for using each tool, and to suggest how and when each tool could be used to maintain producer and shipper income.

4. A major educational effort involving academia, industry, and government is needed to educate producers, shippers, and buyers on how and when to use these tools.

5. A process is needed to provide a transportation outlook to producers, shippers, buyers, and carriers for the near and medium terms.

6. USDA's transportation experts should publish monthly rail shipper survey information.

7. Enlist the support of private shippers, the academic community, USDA, and other government agencies to suggest and coordinate research activities. Encourage USDA to become actively involved with the National Grain Car Council in the Surface Transportation Board (STB).

Arbitration

An arbitration process has been available for many years to settle grain industry disputes. It would seem possible to establish a similar arbitration process to settle transportation disputes. The National Grain and Feed Association is working with railroads to develop an arbitration process, and USDA should support this initiative.

8. Create a mechanism to permit arbitration of transportation disputes.

Advisory Committee

9. USDA should provide input and advice to assure the following:
• Accurate information is available on local grain shipping issues and problems.
• Needed changes are recommended for the STB's authority.
• Studies and advice are provided to shipper groups that wish to consider the purchase of rail lines as well as infrastructure and facility improvements and upgrading.

• Information is provided on access to all sources of private and public funds for infrastructure and facility purchase and upgrading.
• The Secretary of Agriculture is advised on the need for low-interest-rate loans or bonds.

An Open Market Policy
An open market for railcars would help shippers under the greatest stress obtain railcars quickly, rather than waiting in line for the railroad to allocate their cars on a historical use of first-come, first-served basis. An open market would allow railcar prices to rise and fall with supply and demand. Railroads would allow shipper- and investor-owned grain cars to be used along with railroad-owned cars.

10. USDA should encourage the establishment of a market-sensitive car allocation system, allowing the freight market to trade at premiums and discounts to tariff rates, as supply and demand warrant. This system should not preclude the railroad common carrier obligation for a portion of its fleet.

Railroad Mergers
Previous railroad mergers have had a great impact upon the movement of grain, operations of grain handlers, farmers' profits, and the rural economy. Poor performance following mergers can lead to significant losses to the agricultural industry.

11. USDA should recommend that the STB pursue the following when reviewing a potential merger:
• Determine that there is sufficient competition for fair and equitable commerce;
• If the Board approves a merger, the merged carrier should be required to offer acceptable service and performance standards to its customers, with financial penalties for nonperformance;
• In protecting the public interest, the STB should determine whether a proposed merger will have an adverse effect on competition among rail carriers in the region.

Surface Transportation Board (STB)
12. Allow the STB to limit rates in market areas where there is little or no competition.

13. The STB has proposed significant increases in the minimum filing fees and in the fee to file a formal rate complaint. If implemented, the fee schedules could prohibit many small and medium-sized shippers from petitioning the STB. The new fee schedule should also be evaluated for its potential impacts.

14. Establish a grain shippers' hotline in the STB for shippers to report railcar supply problems, and require the STB to make weekly reports to USDA on the number and nature of reports and complaints to the hotline.

VI. MINORITY VIEWS

Minority Report I.

The Committee as a whole has examined a wide range of concentration issues and has reached a consensus on many. All members have worked hard to deal with the issues in a fair-minded and straightforward manner. The report reflects that hard work and willingness to consider issues of all interests represented. It includes many important findings and recommendations, particularly those emphasizing the importance of section 202 of the Packers and Stockyards Act (P&SA) as a mandate to enhance competition and to address abuses of market power in their incipiency, the need to strengthen USDA's capacity to enforce section 202, the importance of prohibiting price discrimination (which the majority politely refers to as price "differentiation"), the necessity of mandatory price reporting, and the importance of protecting bargaining cooperatives from packer intimidation.

Given the differing interests of the members and the constituencies they represent, however, it was impossible to reach consensus on what we consider some of the most important issues before the committee. Overall, the tone of the majority report is too apologetic about the evils of concentration, too optimistic about the benefits of vertical integration, and too negative about the role of government in protecting and enhancing open market competition. This tone is especially evident in sections of the report which were identified during committee deliberations as controversial, but which the committee did not have time to adequately debate or act upon. A good example of this tendency can be found where the majority claims food safety benefits for vertical integration, but refuses to acknowledge potentially greater food safety risks inherent in the mass production systems spawned by vertical integration. "Concentration" is called "coordination," and purported benefits to consumers are stressed, while potential dangers to competition and consumers are ignored.

In some specific areas, however, important recommendations that were debated failed adoption, often by narrow margins. This was especially the case with crucial issues surrounding captive supplies and packer procurement practices. The giants in the industries do, in fact, have very different concerns than the smaller participants. In order to address these differing concerns, the undersigned make the following findings and recommendations to supplement those made by the committee as a whole.[1]

Introduction

The record before the committee and the report itself are replete with evidence showing the growing concentration of all aspects of agriculture. This concentration varies at different levels of the food production chain and its effects likewise differ. The only common thread is that the upper levels maintain profit margins of various sizes within the production cycles, and the lowest, least concentrated levels have become the primary shock absorbers for fluctuations in the commodity cycle.[2]

As recommended by the entire committee, increased transparency of the markets is vital. Yet despite universally available information to even up the bargaining power of those in the livestock business, current market conditions demand further action by the Secretary, and where necessary, by the Congress.

While the voice of producers was heard strongly through public testimony and written submissions, that voice is not fully reflected in the majority Report. The powerlessness of the producers in their dealings with concentrated buyers was heard about again and again. Producers are truly at the mercy of the packers, regardless of whether or not traditional antitrust laws are violated. As the number of buyers steadily declines, with only one bidder for cattle in most circumstances, those who incur the dislike of a buyer face economic ruin. If

a producer raises his or her voice in opposition to packers' practices, there is a very reasonable fear that exercise of free speech will lead to disaster.

The fear of the overwhelming power of the packers was raised by beef producers and echoed in testimony from poultry producers. Retaliation by an integrator for organizing activities can quickly lead to a producer's bankruptcy. While concentration in the swine industry is not yet at the level of the beef and poultry industries, it is proceeding rapidly, and fear of losing independent competitive market outlets for pork producers grows right along with the packers.

While the economic efficiency of the system as a whole and the practices of the giants in their dealings among themselves may be more easily addressed by antitrust laws, the Grain Inspection, Packers and Stockyards Administration (GIPSA) is uniquely qualified to address the problems faced by smaller market participants in their dealings with much larger buyers. The Packers and Stockyards law and regulations are not aimed at economic abstractions but at practices which harm the producer, regardless of the effect on the system as a whole. GIPSA need not show that average prices are affected by unfair practices (the focus of the red meat study). It is enough to show that a single producer faces discrimination.

The USDA study on the red meat industry, the committee report, and the enforcement attitudes of GIPSA in general are overly focused on macroeconomic factors, such as average pricing. To be effective, GIPSA enforcement must be aimed far more at the particular. The recommendations below focus both on the general and the particular, but the minority cannot stress too strongly its belief as to the proper role of GIPSA--regulating practices affecting individual producers.

It is the reasonable fears of producers and the conditions that engender those fears that must be addressed by the Secretary using his broad powers under section 202 and the incipiency theory embodied therein. Producers' distrust of procurement methods and the fear of retaliation by packers and integrators against those who speak out about their disagreements with current conditions need to be addressed if the industry is to function in the long run.

Additional action, beyond the recommendations in the report, must be taken to address the legitimate fears of producers and to safeguard the public's interest in competitive markets, the environment, and a healthy rural economy. Following is the minority's views on measures needed to protect those vital interests.[3]

Captive Supplies

Beef ranchers and feeders have a deep distrust of packers, as reflected in all testimony before the committee. This mistrust is perhaps most strongly fueled by the use of captive supply. Captive supply takes several forms: packer-owned cattle, formula cattle, futures cattle, and custom-fed cattle. All forms of captive supply affect the market for cattle feeders.

Those, like GIPSA, who dismiss captive supply's negative price effects simply recite that if 20 percent of the demand for fed cattle is removed, so is 20 percent of the supply, and the net effect on the market is zero. While the argument is logically appealing at first glance, it does not hold water. First, as recognized by GIPSA, captive supply cuts the tops off the market, by assuring that the packers never get truly desperate for cattle, or "close to the knife" in industry terms. The packers have the flexibility to use the cattle they control when they want them without ever getting into the bidding wars that are the occasional salvation of feeders.

Further, the use of captive supply thins the market, both by lowering the numbers of cattle needed by packers and by removing buyers from the market at various times. While the use of captive supplies may hover in the 20-30 percent range on an annual national basis, its use is far greater in certain areas and at certain times of the

year, exaggerating the effects on affected producers. When captive supplies provide up to 80 percent of a packer's needs on a particular week in a particular area (as was testified to) and only 20 percent of the packers' supply is to be obtained from independent feeders, the independents must necessarily feel severe effects in the prices they receive. They had no inkling of the packers' plans when they bought the feeders and could not know that in the limited time of their cattle's fitness, the major buyers would be absent.

When an offer is made, the producer has no idea of the packer's needs or whether another packer will be in the market before the cattle go out of condition. The producer's marketing window is narrowed, and the price may very well be noncompetitive in the 20 minutes or less that feeders testified they were given to make up their minds.

Perhaps sellers' greatest captive supply concern relates to formula contracts. The discussion of formula contracts within the committee and testimony from supporters of formula contracts focused on the merits of value pricing, not on the way that formula contracts actually work. The majority is in error in assuming that the only way to accomplish value pricing is through formula contracts in their current form. The committee was unanimous in its support of true value pricing for all comodities under consideration. Farmers should get paid more for good products and less for inferior products. Buyers, likewise, should get what they pay for. Pricing on the average, while still prevalent in the beef industry, is on its way out.

The problem with formula pricing, as it is currently used, is not a problem of value pricing. Rather, the problem lies in the base from which the carcass value is calculated. In all the methods currently used, the packer has the power to artificially lower the base price from which premiums and discounts are calculated.

When the futures market is used to establish a base, the packers are heavy players on both sides of the market. Their futures market activities, whatever the motivation and whether the packers are long or short in the market, affect the price they pay for formula cattle and, ultimately, for negotiated sales. The USDA study on the red meat industry, indeed, found that sales based on the futures market averaged 2.5 percent less than other sales methods. It dismissed the price difference as minor, but 2.5 percent is a big difference in a thin-margin business like cattle feeding. That already substantial penalty is, in fact, understated if, as packers claim, contract cattle are better cattle than those bought on the spot market.

Whatever the amount of the penalty paid by producers selling on a futures basis, it cannot be economically justified. The study's rationalization that the difference is simply the price paid by producers for price stability fails to recognize that the stability benefits both sides. The producer should not pay the whole price for a two-sided hedging transaction.

When the formula is based upon the average spot price for the preceding period, that base has three weaknesses which can be used to artificially lower the price received by the producer. First, formula producers and packers claim that the best cattle are sold on a formula basis. That means that the pool of cattle sold on a spot basis is below average in quality. Thus, the "average" market price upon which the formula cattle are sold is, in reality, a below-average price. Second, the base price is again determined in large part by the packers' own market activities. They determine what price is bid for non-contract cattle. If they bid low for non-formula cattle, their price for formula cattle likewise will be lower. Regardless of whether packers consciously act in this manner, it is in their best interests to do so. The packers' incentive to manipulate the market raises the level of producer distrust perhaps more than any other single factor. Finally, as emphasized over and over, the use of captive supply thins the market.

As the percentage of captive supply grows, the pool of cattle sold on the spot market declines and becomes less reliable as an accurate gauge of market conditions.

Producers cannot rely upon packers' goodwill, hoping that the packers can resist the temptation to act anticompetitively, or to lower their overall procurement costs. The committee, in fact, heard of specific instances where packers took steps to lower the average price upon which captive sales are based. Perhaps the most blatant evidence of market manipulation heard by the committee related to nonreporting of certain transactions. Several witnesses testified that on occasions where packers paid "above-market prices," an explicit condition of the deal was that the price not be reported. Thus, the market price upon which all other purchases were based, in particular formula cattle trades, was artificially low, and all sellers, except the one with the special deal, suffered. Even that seller will suffer in the long run.

Findings on captive supplies
• Use of captive supplies engenders fear and distrust of market fairness.
• Use of captive supplies endangers competitive operation of livestock markets.
• Use of factors within the control of packers as a base price for purchase of captive supply is a violation of section 202 of the P&SA.

Recommendations on captive supplies
• Packer feeding of livestock should be eliminated except where the owners of the livestock own the packing facility in a cooperative arrangement. If packer feeding is allowed, the livestock must be offered for sale on an open-market basis, and the price at which these livestock move into the market should be reported separately.
• Packers and principals in packing operations should be barred from custom-feeding livestock for others.
• Packers should be prohibited from futures market trading except for economically justifiable hedging activities.
• Formula contracts as they are presently constituted should be banned.
• Value-based pricing must be based upon readily verifiable market factors outside the control of the packer/buyer and must be made uniformly available within the limits of the packer's purchasing needs.

Credit Policies
The easy availability of credit to large operations can have immensely distorting effects on the industries so financed. For example, it has been reported that one of the prototypical large swine operations lost about $100 million last year. Nonetheless, their production and, indeed expansion, continue unabated. One can only speculate that they are simply too big for their lenders to allow them to fail. The capital-intensive nature of their operations has required the participation of and encouragement by their lenders. Foreclosure is simply not an option when the collateral is single-purpose facilities which can be used for no other purpose than to "crank out pork."

Even if the lenders take action, foreclose, and resell the foreclosed assets, the facilities will remain in use and the second-generation producers will have artificially deflated production costs after buying the facilities at fire sale prices.

An analogy that comes to mind is the fate of office buildings in the over-built market of the 1980s in many cities. The initial builder (often subsidized by the public) goes under, but by the second or third owner, the capital investment (a fraction of the original cost) makes economic sense, and the building prospers. If a mega-farm defaults, the property will be sold as many times as needed to reflect the true value of the facility. When the final owner shows a profit, he or she will be touted as showing the efficiency of mega-production, and the boosters will ignore the initial overcapitalization that led to its failure.

Likewise, if the lenders restructure the loans, the mega-farm receives a subsidy of the sort so

criticized in the farm credit reforms enacted in the wake of the great credit debacle of the 1980s. It is easy to speculate as to the possibilities of financial disaster for the swine production industry, by comparing the current livestock industrialization boom with the land boom of the 1970s that led to the crash in the 1980s.

In the 1970s, lenders encouraged farmers to buy, leverage, and expand. Farmers mortgaged their land, leveraged their assets, and in all respects heeded their lenders. Conditions changed. Commodity prices plummeted, and interest rates skyrocketed. Land values fell to 25-50 percent of their 1980 value. Farmers were bankrupted by the thousands. Lenders likewise paid the price of the shared folly. Banks throughout the country became insolvent; the Farm Credit System needed a Congressional bailout to regain solvency. The Farmers Home Administration lost billions.

However, the expansion fueled by the easy credit and "progressive" expansionist lending of the 1970s maintained its effects in the 1980s. While there could be no doubt as to the wrong-headedness of the 1970s credit policies encouraging expansion, consolidation, and concentration, those policies achieved their expansion goals. The bankrupt farmers who expanded beyond economic reality left the land or were allowed to retain their holding for a fraction of the amount they had paid for it. Even if they lost their land, the holdings expanded artificially in the 1970s were passed on intact to the new beneficiaries of credit. These new beneficiaries, having bought their new holdings at artificially reduced prices, could publicly attest to the supposed efficiencies of concentration.

Lenders of the 1990s, by promoting expanded concentrated livestock operations, are doing the same thing that got 1970s lenders and producers in trouble. An analogous downturn in livestock profitability or a parallel boost in the cost of capital will similarly leave its mark on the countryside as the foreclosed barns are put to use with new operators made artificially efficient by the bankruptcy of their predecessors. The consequences of capital wrongly pressed into the service of concentration are irreversible.

Governmental or quasi-governmental agencies charged with serving agriculture's credit needs should concentrate their services on the needs of family-sized operations, with the goal of avoiding permanent overcapacity in agricultural production.

Recommendation for credit
The Farm Service Agency should not make or guarantee loans for contract livestock production (other than poultry) because these operations do not meet "owner/operator" eligibility requirements, and the subsidy or credit enhancement provided through these loans will be captured by the integrator.

Environmental Concerns & Vertical Integration
Farmers and the public as a whole are concerned about the environmental effects associated with large-scale livestock facilities. North Carolina, Missouri, Iowa, and Minnesota have experienced large-scale pollution incidents associated with large hog confinement units. A Minnesota farm paper found that problems associated with concentrated swine production was the number one farm issue of 1995. In fact, the *Times*, a Raleigh, North Carolina, newspaper, won a Pulitzer prize for its series on the problems arising from the expansion of concentrated North Carolina hog production.

These problems are not simply the result of individual farmers' decisions to grow in order to compete. The trend toward immensity is fueled by the vertical integration within the industry. The data presented to the committee demonstrates that the largest production facilities either are owned by the packers or produce and sell subject to total control by the packers. In order to compete, individual crop and livestock producers are banding together to form ever-larger production

units with odor and waste disposal problems common to all.

The vertical integration behind these trends is increasing and, except in Iowa and Nebraska, is basically unregulated. Iowa, by forbidding packers to own swine, still maintains its top rank in swine production, but guards against the gradual monopolization of its important industry.

Integration is not just a matter of losing family farms along with their attendant benefits for all of rural America; it is a factor in creating the problems that have been described.

A prime concern of the neighbors living next to large-scale confinement operations is the odor. It is often said that technology is available to prevent odor problems, but that it just costs too much. This is perhaps the clearest statement as to external costs of large-scale production. Large-scale integrated producers could not compete if they had to pay for the social costs they generate. Neighbors, instead, must pay that cost, and their anger at that burden is a threat to all producers. Indeed, other countries have made their producers address the odor and water pollution problems, which is one reason why their stated cost of production exceeds that of their American counterparts.

While pigs have always smelled, the corporate face on hog raising exacerbates the neighbors' problems. First, with the mammoth size of these operations, the odor is greater, both from storage and disposal. Second, the owners do not live on the farm and do not share the problem or the motivation to minimize it that traditional farmers do. Larger operations also pose a greater risk to ground water. While some states include lagoon standards in permit requirements, it is much more difficult to mitigate any release from a very large facility.

The social costs of concentration are vast, and this report cannot do them justice. The job of government policy at all levels is to assure that social costs are reflected in the price of the product which generates them. That is not being done at any level of concentrated agriculture. Through legislation and regulations, USDA must take action to ensure the proper functioning of a competitive economy. Not only must the information provided be equally and immediately available, as discussed elsewhere, but the relevant environmental, taxing, and land use agencies at all levels of government must enact measures to assure that environmental costs are reflected in the production costs of concentrated livestock production and processing.

Environmental & vertical integration recommendations

- Strengthen rules for animal feedlots to make them consistent and effective in addressing all aspects of pollution (as recommended in the report), including odor, water, and air pollution, and to prevent bidding wars between States willing to sacrifice their environmental quality.
- Review all contracts and arrangements between large feedlots and packers for restraint-of-trade violations, including exclusive dealings and price discrimination.
- Vigorously enforce the Clean Water Act to assure compliance by feedlots at the same level as other industries with similar environmental impact.
- Prohibit packer ownership, operation, management, or financing of any livestock (including swine but excluding poultry) production or feeding operations.

Checkoff-Financed Producer Organizations

Extensive dissatisfaction was voiced by beef producers over the formation of the National Cattlemen's Beef Association because of packer representation in the organization's policy formation. Allowing representation of an industry segment with interests that may be contrary to the interest of the producer, was viewed as an unfair use of mandatory nonrefundable beef checkoff funds. In effect, the splintered cow-calf and feedlot operations were helping support the concentrated interests of the packing segment.

The activities of the various checkoff programs tend to be focused on large-scale production, reflecting, no doubt, the wishes of the largest contributors. This further contributes to concentration at the production level. Those who object to commodity group activities or the resulting concentration have little chance to show their dissatisfaction since the checkoffs are not refundable.

Findings

- The use of commodity checkoff funds to finance research and promotion of the interests of the largest market participants accelerates the rate of concentration in the industries from which the funds are withheld.
- The use of nonrefundable checkoff funds to support an organization that is viewed by contributors as not accountable to its members is improper.
- Those who disagree with a promotion organization's membership and policies should not be compelled to support it.

Recommendation

All checkoff fees should be made refundable.

Conclusion

The importance of the issues addressed by the committee cannot be overstated. All consumers and all producers will feel ill effects if market power grows without accompanying accountability. Some concentration of agriculture is, indeed, inevitable as farmers retire or otherwise voluntarily leave the farm, and as technology provides increasing economies of scale. However, as briefly described above, there are severe anticompetitive forces at work in the livestock industry that are artificially accelerating the rate of concentration.

Once concentration occurs, it is almost impossible to reverse. We have thus concentrated our recommendations on preventive measures in hopes of allowing "progress" but preserving competition. Such a strategy is not only in the interest of independent market participants, but is vital for the long-term protection of the American consumer. Without immediate and strong action by the Secretary, and where necessary, by the Congress, the interests of artificial concentration will prevail. We stand ready, individually and as a group, to lend our help in this vital task.

Notes:

1. Many of the proposals in this minority report lost by only a single vote, and almost all received votes from other committee members. Nonetheless, the minority has not sought individual support for individual recommendations, but has chosen to present its unified statement as a whole.

2. Perhaps the greatest area of concentration not examined by the committee relates to the retail and wholesale segments. We believe that further study of these levels, their market power, and their effect upon the lower levels of the production chain is extremely important.

3. This question--perhaps the biggest in the minds of all committee members and, in all likelihood, all industry participants--remained unaddressed. Should the big three beef packers be broken up? The bald fact that three companies control almost 80 percent of fed cattle slaughter, along with an ever-increasing share of the cow/bull and pork market, leads us to believe that divestiture should be required. Since evidence as to effects and testimony as to enforcement options were lacking, however, we decline to discuss the issue in any detail.

Respectfully Submitted to the Honorable Dan Glickman,
Secretary, United States Department of Agriculture

Paul Strandberg, Minnesota

Herman Schumacher, Vice Chair, South Dakota

Marty Strange, Vice Chair, Nebraska

Becky Edington, Georgia

Tyrone Moos, South Dakota

Lois Wales, Texas

Minority Report II.

The charge of this committee was to review the factual information relating to concentration in agriculture, with primary concern for concentration in meatpacking.

Additionally, we were charged with reviewing testimony by concerned parties who feel they have information pertinent to this subject. The overwhelming conclusion coming from the factual information, along with the numerous prior investigations into this matter, is that consolidation has very little impact on producers and consumers, or on other market participants, from the concentration in the meatpacking sector.

1. The economic data reveals that price responses to increased production are clearly in line with historical norms and that supply and demand are in balance. This is supported by analysis (see submission by Andrew Gottschalk, 1996).

2. The relationships are in line with conditions that occurred prior to "captive supplies" and that captive supplies have very little or no impact on prices.

3. The recent concentration study done by GIPSA in Kansas shows that concentration had little, if any, impact on prices, which coincides with dozens of other reports on the subject. (Gottschalk, 1996.)

4. The most recent study done by GIPSA in Kansas is the most in-depth and conclusive study to date. It found no evidence to support claims of price manipulation, collusion, or any unlawful activities by meatpackers. The conclusive study is important for all to consider before making final recommendations.

The committee heard from a large number of people who "feel" that there is something wrong, and that the recent price declines must be attributed to something other than the large increases in production. The culprit, according to some, has always been the meatpacker. As concentration levels have increased, that gives rise

to the "idea" that the meatpackers are controlling the market. Producers point to the 1920s as an example of how to deal with concentration, yet they fail to realize that the actions taken in the 1920s (the Consent Decree and the P&SA) were a result of strong evidence of price manipulation, collusion, and total control of commerce, not concentration. In fact, in the 1920s, packers were meeting almost daily to set prices paid to producers and retailers. It is from this that producers' concerns arise, and yet the current situation mirrors the 1920s only in the number of participants. There is no evidence of any other collusive, monopolistic behavior.

The charge of this committee must be to alleviate the unfounded concerns of the producer segment by providing solid information regarding the significant increase in production, and the resulting decline in prices. Additionally, producers need to be brought up to date with current business practices and their effect on trade.

With regard to the committee report, I respectfully submit the following comments:

1. The committee heard testimony from producers who believe they have been injured. Although the pain is real and the recent declines are causing economic loss in the producer sector, the factual evidence supports the recent increase in production as the reason, rather than meatpacker behavior.

2. The overwhelming consensus of the committee is to recommend increased information to all sectors as a way to alleviate the recent concerns. The committee, however, had dissension as to the method of increasing information. My recommendation is to provide the Agricultural Marketing Service (AMS) with additional resources to meet this demand, and not install a high-cost system of mandatory price reporting that will only add cost to the meatpackers, furthering our struggle with competitive cost structures when compared to other meat and global competitors.

3. Along with increased price reporting, the retail price series needs to be totally overhauled. It is an outdated series that has little use and effectiveness, and yet is being used to compare the profitability of packers and retailers today versus in past years.

4. Export data is another area of information that is in need of additional reporting efforts.

5. Finally, I recommend an educational series to aid producers in understanding the current market environment and business practices.

Respectfully Submitted to the Honorable Dan Glickman,
Secretary, United States Department of Agriculture

Kenneth Bull, Kansas

Minority Report III.

As expressed by the U.S. sheep industry during the formulation of the USDA study on *Concentration in the Red Meat Packing Industry* in 1992, and at the onset of this committee's review, exclusion of specific investigation regarding the domestic lamb market is a serious omission. I believe this lack of investigative data on the lamb market detracts not only from the findings of the USDA study, but from the committee's report as well.

Data and findings of the Department of Justice's Antitrust Division investigation into the lamb industry during 1991-93 must be considered by USDA in evaluating the concentration issue. The most recent GIPSA study on the U.S. lamb market was released in 1987. Since that study, the lamb industry has experienced major changes in both the producer and processing sectors. These dynamic changes cannot be adequately examined for impacts of concentration in the lamb market by comparisons to other livestock sectors.

Respectfully Submitted to the Honorable Dan Glickman,
Secretary, United States Department of Agriculture

Steve Raftopoulos, Colorado